Supreme Court of the United States

OCTOBER TERM, 1909

No. ~~707~~ 443

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GEORGE WENDELL PHILLIPS
Appellant

v.

FIFTY ASSOCIATES, et Al.

APPEAL FROM THE CIRCUIT COURT OF THE UNITED STATES FOR THE DISTRICT OF MASSACHUSETTS

BRIEF FOR APPELLANT

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CONTENTS.

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BRIEF FOR APPELLANT.

This is an action brought originally in the Circuit Court of the United States for the District of Massachusetts by George Wendell Phillips as a shareholder in the Fifty Associates, a Massachusetts corporation, against that Company and its officers and directors to restrain them from making the return or paying the tax or otherwise complying with the provisions of Section 38 of the Act of Congress approved August 5, 1909, known as the "Corporation Tax Law."

The material provisions of the Act are as follows:—

> "That every corporation, joint stock company or association, organized for profit and having a

capital stock represented by shares, and ... surance company, now or hereafter or... in- shall be subject to pay annually a spe... tax with respect to the carrying on or doi...cise by such corporation, joint stock company...ness ation, or insurance company, equivalent ...oci- centum upon the entire net income over per five thousand dollars received by it from ...ove during such year, exclusive of amounts ...rees it as dividends upon stock of other co... by joint stock companies or associations, ...ons, companies, subject to the tax hereby im...nce

The action is in equity. It is founded, as ... tion, first, upon diverse citizenship, the appe...dic- a citizen of the State of Nevada, and the appe...eing zen of the State of Massachusetts, and the ...citi- dispute exceeding, exclusive of interest and ...r in sum of $2,000, and second, upon the fact that ... the arising under the Constitution and laws of ... suit States, and especially under the Internal Re... ited of the United States. ...aws

A demurrer was filed on behalf of the defen... and in the Court below, the demurrer was sustain... the bill dismissed.

The plaintiff appealed directly to this Court ...ant to the Statute.

ASSIGNMENTS OF ERROR.

The assignments of error are as follows:—

I. That the Court erred in not holding that so much of the Act of Congress of the United States, entitled: "An Act to Provide Revenue, Equalize Duties and Encourage the Industries of the United States and for Other Purposes," approved August 5, 1909, as relates to the assessment and collecting of a tax on the net income of corporations and the filing of returns of corporations, as specified in Section thirty-eight of the said Act, was unconstitutional, null and void, in that:

(*a*) the said Act of Congress is in violation of the Constitution of the United States, and particularly of Article one, Section seven, in that the said Act above mentioned originated in the Senate of the United States, and was concurred in by the House of Representatives subsequently thereto, whereas it is required by said Article and Section of the Constitution of the United States, that all bills for raising revenue shall originate in the House of Representatives, but the Senate may propose or concur with amendments as on other bills.

(*b*) The said Act of Congress is in violation of the Constitution of the United States, and particularly Article one, Sections two and nine, in that the tax imposed by the said Act, although described in said Act as a special excise tax, is in fact and in legal effect a direct tax and is not apportioned among the several States, according to their respective numbers whereas it is required by the said Article and Sections of the Constitution that no direct tax shall be laid by Congress, unless in proportion to the census.

(*c*) If the tax imposed by the said Act of Congress is not a direct tax, then the said Act of Congress is in violation of the Constitution of the United States,

and particularly of Article one, Section eight thereof, in that the tax imposed thereby is not uniform throughout the United States, in this that the said Act of Congress exempts from the payment of said tax all corporations, joint stock companies or associations having an annual net income of less than $5000.00; and is not uniform throughout the United States in this that said Act exempts from the making of the return therein prescribed and from the payment of the tax thereby imposed all labor, agricultural or horticultural organizations and fraternal beneficiary societies, orders or associations operating under the lodge system, and providing for the payment of life, sick, accident and other benefits to the members of such societies, orders or associations, and dependents of such members and domestic building and loan associations organized and operated exclusively for the mutual benefit of their members, and all corporations or associations organized and operated exclusively for religious, charitable or educational purposes, no part of the income of which inures to the benefit of any private stockholder or individual; and is not uniform throughout the United States in this that it is not imposed equally upon corporations, joint stock companies and associations having like charters and franchises and enjoying like benefits under the laws of the United States and the several States; and is not uniform throughout the United States in this that it is not imposed equally upon corporations, joint stock companies and associations carrying on and doing the same and equal business and enjoying the same rights and privileges in regard to the carrying on and doing of such business; and is not uniform throughout the United States in this that it is not imposed upon corporations, joint stock companies or associations organized for profit, but not having a capital stock divided into shares; and is not uniform throughout the United States in this that it is not imposed upon corporations, joint stock companies or associations having an

annual net income exceeding $5000.00, if said income is derived as dividends upon stock of corporations, joint stock companies or associations or insurance companies, subject to the tax thereby imposed; and is not uniform throughout the United States in this that the said Act exempts from the tax thereby imposed and from the making of returns thereby prescribed, individuals, firms, co-partnerships and trusts, similar to those hereinbefore described, of some of which the shareholders enjoy freedom from a general partnership liability, carrying on and doing the same or similar business for profit, whereby it is provided by said Article and Section of the Constitution of the United States that Congress shall have power to levy and collect taxes, duties, imposts and excises, to pay the debts and provide for the general welfare of the United States, but that all duties, imposts and excises shall be uniform throughout the United States.

(*d*) The said Act of Congress is in violation of the Constitution of the United States, and more particularly of the provisions of the Fifth Amendment thereto, in that under the provisions of the said Act, the defendant corporation will be deprived of its property, without due process of law, and particularly in this that, through the publicity of its business, the privacy of its affairs will be largely, if not entirely, destroyed, and its competitors will be able to gain an intimate knowledge of what have hitherto been the private affairs and concerns of the defendant corporation, while corresponding publicity of the private affairs and concerns of all other corporations, joint stock companies or associations will not necessarily result, nor will any corresponding publicity of the private affairs and concerns of individuals, firms, co-partnerships and trusts, similar to those hereinbefore described, of some of which the shareholders enjoy freedom from a general partnership liability, carrying on and doing the same or similar business for profit result; and in this that the said assessment if made will be laid upon the de-

fendant corporation and not necessarily upon all other corporations, joint stock companies or associations, and not at all upon individuals, firms, copartnerships and trusts, similar to those hereinbefore described, of some of which the shareholders enjoy freedom from a general partnership liability, even though they may be engaged in the carrying on or doing of the same or similar business, whereas it is provided by the Fifth Amendment to the Constitution that no person shall be deprived of his property without due process of law.

(*e*) The said Act of Congress is in further violation of the Fifth Amendment to the Constitution, in that under the provisions of said Act the private property of the defendant corporation will be taken for public use without just compensation and without any compensation whatsoever, and especially in this that the private affairs, books, papers, records, business and trade-secrets of the defendant corporation and the contents of its books, papers and records are to be taken for publication and are to be given to the Collector of Internal Revenue and to the Commissioner of Internal Revenue and to the public in the form of public records, whereas it is provided by the Fifth Amendment to the Constitution that private property shall not be taken for public use without just compensation.

(*f*) The said Act of Congress is in violation of the Constitution of the United States, and particularly of the provisions of the Fourth Amendment thereto, in that it violates the rights of the defendant corporation to be secure in its papers, effects, books, records, business, private affairs and trade-secrets against unreasonable searches and seizures, in this that by the provisions of said Act should the defendant corporation by its officers fail, neglect or refuse to make the return therein provided for the Commissioner of Internal Revenue is thereupon empowered to examine through any regularly appointed Revenue Agent all books and papers bearing upon the matters required to be included in the return

and to make up a return therefrom, whereas it is provided by the Fourth Amendment to the Constitution that the right of the people to be secure in their papers and effects against unreasonable searches and seizures shall not be violated.

(*g*) The said Act of Congress is in violation of the Constitution of the United States in this that the requirement to make said return for public record and the requirement to pay said tax and the depriving thereby of the defendant corporation of its property without due process of law and the taking thereby of the private property of the defendant corporation for public use without just compensation, and the violation thereby of the right of the defendant corporation to be secure in its papers and effects against unreasonable searches and seizures, all as hereinbefore set forth, are burdens upon the charter and franchise of the defendant corporation, Fifty Associates, granted as aforesaid by the State of Massachusetts, and upon the right and power of the State of Massachusetts to grant, maintain and preserve the same to the defendant corporation and are an invasion and burden upon a prerogative, power, instrumentality and function of sovereignty belonging to the State of Massachusetts and which were never agreed to either expressly or by implication by the State of Massachusetts or by the people of the State of Massachusetts at the time the said State was admitted into the Union or before or since that time.

(*h*) The said Act of Congress is in violation of the Constitution of the United States, and particularly of the Tenth Amendment thereto, in this, that the carrying on or doing of business for profit by a corporation, joint stock company or association created under the laws of the several States is not within the taxing power of the United States, and any Act of Congress which by its terms imposes a tax upon the carrying on or doing of business for profit by any such corporation, joint stock company or association, imposes a burden and a tax upon and

is an interference with the free exercise by the several States of the powers expressly reserved by the said States to charter and incorporate corporations and to grant charters and franchises to such corporations.

(*i*) The said Act of Congress is not a proper exercise of the legislative power granted to Congress and that the said Act of Congress is otherwise in violation of the Constitution of the United States.

II. That the Court erred in not granting to the complainant relief prayed in and by his bill or any part thereof.

III. That the Court erred in sustaining the demurrer to said bill.

IV. That the Court erred in dismissing the said bill with costs.

These assignments of error set up various grounds upon which the appellant contends that the Act in question is unconstitutional and void, and also set up generally that the Court erred in not granting the relief prayed for and in sustaining the demurrer and in dismissing the bill.

The appellant contends:—

(1) That the defendant corporation is not within the provisions of said Act.

(2) That if the defendant corporation is within said Act, the Act is unconstitutional and void.

I.

The Defendant Corporation is not Within the Statute.

The appellant's first contention is that the defendant is not within the intention of the law and therefore not subject to the tax. It is important, therefore, at the outset to consider what corporations are included within the scope of the statute, and upon what, speaking precisely, the tax in question is levied.

1. The Act applies only to such corporations as are carrying on or doing business.

The appellant will contend, for reasons set out at length below, that although the tax is described in the Act as an "excise" tax, it is not such in fact, but is in substance and in reality a tax upon income.

If, however, it is to be regarded as an excise, there are three possible views as to what is the precise thing upon which the tax falls.

> (1) That it is a tax upon the franchise granted by the State whereby individuals are enabled to do business in the corporate form and with limited liability.
>
> (2) That it is a tax not upon the franchise itself which is granted by the State, but upon the exercise of the franchise.
>
> (3) That it is a tax not upon the franchise nor upon the exercise of the franchise simply, but only an excise upon "the carrying on or doing business."

For purposes of the present discussion, it is sufficient to say that if the tax be regarded as laid in reality upon income it is, at least as to such portion of income of any corporation as is derived from real estate or from invest-

ment in personal property, a direct tax, and, therefore, unconstitutional under the doctrine of the case of *Pollock* v. *Farmers Loan & Trust Company*, 157 U. S. 429, and on re-hearing, 158 U. S. 601.

Regarding the tax, however, for present purposes as a true excise tax, if the first of the three views above set out be taken, namely, that it is a tax upon the franchise granted by the State, the appellant believes that it is likewise unconstitutional under the doctrine of the many cases which deny to the Federal government the right to tax the instrumentalities of the States. See for example the case of *Knowlton* v. *Moore*, 178 U. S. 41, to the effect in substance that Congress may not tax the power of the State to regulate successions although it may tax the recipient who takes property in accordance with such regulations.

Either of the remaining views may conceivably be taken, namely, that it is a tax upon the exercise of the corporate franchise or that it is a tax upon carrying on or doing business.

The wording of the act would seem to indicate that it is not intended to levy the tax upon any corporation *unless* it is engaged in carrying on or doing business, and, therefore, that the mere fact of a corporation exercising its franchise does not subject it to the tax. A corporation may be exercising its franchise and still not be engaged in "business." No corporation is taxable under the act, unless it is engaged in business. The conclusion would seem to follow, therefore, that the tax is intended to be levied upon "carrying on or doing business."

It is suggested, however, that it may not be necessary to carry the analysis of the precise subject of the tax to this extent, for the Act seems to indicate that, in any event, whatever is the subject of the tax, unless a corporation is engaged in "carrying on or doing business,"

it is not intended to be taxed. There are only two alternatives, namely:—

(1) Either it is a tax upon the exercise of the franchise and is imposed upon such exercise only when the corporation is engaged in business, or

(2) It is a tax on the "carrying on or doing business" itself.

In neither case is any corporation to be taxed unless it is so engaged in business.

2. The Defendant Corporation is Not "Carrying on or Doing Business."

It appears from the record (pp. 2–3), that the defendant corporation was chartered by the Commonwealth of Massachusetts in the year 1820, that this charter was granted to the Company without any reservation to the State of the right or power to amend, alter or repeal, that

> "the property of said corporation consists wholly of real estate or interest therein or leaseholds thereof, except such amounts of income as may from time to time have been set apart as surplus or reserved for working capital or such income as may have been accumulated but not declared in dividends,"

and also that

> "the business of said corporation, so far as it may be called a business, is the holding and managing of the property aforesaid, and such business is transacted and conducted wholly within the City of Boston, in said Commonwealth, and the income of said corporation, except as the same may be derived from accumulated profits, is exclusively derived from real estate; and that although empowered by its

> charter to buy and sell real estate, and build, pull down and rebuild the same as a business, the said corporation is not engaged in the doing of the same as a business for profit, nor is it so engaged at all, except in so far as the doing of the same may be an incident to the management of its property or the investment of its funds."

In the ordinary acceptation of the words, do such acts as have been described,—such care and management over real estate investments,—constitute the "carrying on or doing business?"

It was decided in the *Pollock* case that the income from real property or investments in personal property could not be taxed under the income tax law.

It was also decided in the *Spreckels Sugar Refining Company* case [192 U. S. 397], that under the law which imposed a special excise tax upon the business of refining sugar, measuring such tax by the gross income from the business, the income from real estate which was primarily used by the company in connection with and in the prosecution of its business of sugar refining, was properly included in computing the tax.

If the tax in the *Pollock* case had been nominally an excise tax upon the doing of the business of investing one's own property, it is scarcely conceivable that the Court would have reached any different conclusion as to the directness of the tax. If an individual were compelled to pay a tax upon the income from his investments in real estate, it would not matter whether the tax were called a tax upon his income from that source, or whether he were described as being engaged in the business of investing his property in real estate.

Every person who has investments in real estate, unless they be of that unusual character which is sometimes found,—namely, very long leases where the owner

parts entirely with the control of the property and simply remains passive and receives the rentals,—is obliged, in the proper care of his investments, to look after his property, to make repairs when needed, and to attend to the making of leases, enforcing collection of rentals, evicting tenants, paying taxes, and generally the care and management of the property. This was doubtless true in the *Pollock* case, and it requires no argument to show that if a similar tax was admitted to be levied upon the business of managing real estate, then so far as such so-called "business" consisted in the management of one's own investments in real estate and the proper care and oversight over one's property as incidental to such investments, such tax would be open to the same identical objections which were found insuperable in the *Pollock* case. In other words, it would not help the tax to change its name.

If the tax be regarded, therefore, as a tax upon the doing of business, it cannot be applied to the so-called business conducted by the defendant Company, for if it did, it would be, at least as to such Company, unconstitutional and void.

Let us assume a corporation owning real estate, all of which it has leased for a long term of years so that the only reason for the existence of the corporation is that it may receive the rentals from such real estate and transmit the same to its stockholders. We have, then, a case of pure investment. In such case it would seem clear that a tax "with respect to the receipt of such income" is a tax upon the income itself. To call this receiving of income a "business" and to hold that by so doing the tax which was before unconstitutional and void can be made constitutional and valid, would be a mere subterfuge. But, as has been noted above, all investments in real estate, apart from this exceptional kind of

investment, involve as incidental thereto some degree of care and attention to the property.

The question then is,—does this care and attention which is given by an owner to his property as incidental merely to the protection and preservation of his investment, constitute the carrying on or doing business within the meaning of this act? We are led to the conclusion that it does not, and that this is independent of the question whether these same incidental acts of care and management, if done independently by some one other than an owner of such property, would or would not constitute the "carrying on or doing business" within the statute.

In *Parker Mills* v. *Commissioners of Taxes*, 23 New York, 242, a statute of the State of New York enacted that all persons and associations "doing business" in the State of New York, as merchants, bankers or otherwise, and not residents of the State of New York, should be assessed and taxed on all sums invested in any manner in such business. The Parker Mills was a foreign corporation manufacturing nails in Massachusetts and Rhode Island. It had a depot and agent in the City of New York to whom it transmitted nails for sale. Its only business within the State of New York consisted in making such sales, the proceeds of which were remitted to the corporation in Massachusetts. The annual sales of the agent in New York City amounted to about Three Hundred Thousand Dollars ($300,000.00) and the value of the nails which he had in store was Ten Thousand Dollars ($10,000.00). The Court said, (per Selden, J., pages 243-244),—

> "The words descriptive of the property in respect to which they are to be assessed, are among the most indefinite in the language. The word 'business' embraces everything about which a person can be

> employed; and a sum is 'invested' whenever its amount is represented by anything but money. No conclusion can be arrived at in this case, by following out the precise lexicographical meaning of these terms. The statute is to be interpreted, therefore, by the light to be obtained from its general scope and tenor: from other statutes *in pari materia:* and from a consideration of the evils and abuses at which it was aimed."

and the Court proceeded to hold that the acts which took place in New York were so far merely incidental to the manufacturing business of the Company that they did not constitute the doing of business within the statute, and consequently that the corporation was not subject to the tax.

In *Re Alabama and Chattanooga Railroad Company*, 9 Blatchford 390, a petition in involuntary bankruptcy was filed in the Southern District of New York, against the railroad company, under the bankruptcy act of 1867, whereby such proceeding might be prosecuted in the district in which the debtor had carried on business for a stated time. The railroad Company was an Alabama corporation owning and operating a railroad in the States of Alabama, Georgia, Mississippi and Tennessee. It appeared that the Company had an office in New York City where its officers acted, its board of directors met, and where it contracted debts and made loans, purchases and payments. The Court said, (per Woodruff, J., page 397),—

> "In its broadest sense, the term 'business' includes nearly all the affairs in which either an individual or a corporation can be actors. . . . The conduct of any and all of the affairs of a corporation is business. Does, then, the doing of any acts whatever pertaining to the affairs of a railroad corporation constitute 'carrying on business,' in the

sense of the Act? Has the term, 'carrying i-
ness,' the same meaning as 'transacting a
business'? If the necessities or interests o-
road company require that an agent should t
to a timber region to purchase or otherwise e
(*e.g.*, by cutting, sawing, etc.) materials s
superstructure, is that carrying on busines
If it send an agent or agents, to a city, the
capital, to negotiate its bonds and raise m
aid of the construction of its road, and such
be continued for that purpose, and for receivi
quent remittances and making payments of
or other indebtedness, at an office provided
is that carrying on business in such city, wi
meaning of the Act? I am constrained, not
considerations already suggested, but by wha
the words themselves, should be deemed thei
interpretation, to answer these questions in t
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many affairs which are merely incidental, an
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the place where the business—that which is
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unjust and unreasonable to regard such tran
as a carrying on of business, in the sense of
"Carrying on business" looks to the scheme
pose to which such transactions tend, and no
incidental transactions themselves. Thus, t
ness of a railroad corporation is, by its char
construction, maintenance, and operation of
road. That is its business. In aid thereof,
be necessary or expedient to employ agen
agencies—since it can only act by agents—i
places than those in which its business of co
ing, maintaining and operating the road can be
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lateral or incidental. They do not, in a just
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We deduce from the foregoing, therefore:—

First. That the present act is to be interpreted not by giving the broadest possible interpretation to the words, "carrying on or doing business" because that would lead to results at once unreasonable and unconstitutional.

Second. That the carrying on or doing business is not to be applied to every activity of a corporation; and that, where similar language has been used in other cases, the Courts have restricted the application of the words to the principal or primary pursuit or occupation of the Company and have not extended it to matters purely incidental.

Following out this reasoning, it would seem appropriate that if the principal pursuit of a corporation is not such as would be properly described as "carrying on or doing business" any acts or things which it might do as incidental to such principal pursuit should be regarded merely as merged in the principal pursuit and not independently "carrying on or doing business."

Construing this Act, therefore, in the light of previous statutes and of the line of cases in which those statutes have been passed upon, the natural conclusion is as follows.

If a corporation is engaged solely in the occupation or pursuit of investing its money in either real estate or personal property and if it does nothing except such acts and things as are purely incidental to its investments and to a proper care and attention to the subject of the investment for the protection and preservation thereof, then it is not engaged in business within the Act even though such acts done by it as incidental to its investing operations might, if done by others as an independent pursuit, fall within the statute.

On the other hand, if a corporation is principally engaged in some form of occupation which is clearly to be regarded as the doing of business, such, for example, as the common forms of manufacturing or mercantile pursuits, and if in the conduct of such business it uses real estate incidentally and such real estate contributes to the aggregate income from the business, yet it is proper in case of an excise tax upon such business, to measure the amount of the tax by the entire income without deducting anything on account of the real estate.

The decision in the *Spreckels* case goes to the point of deciding that in the case of such excise tax upon the business of sugar refining, the income from real estate actually used by the Company and primarily so used as incidental to the carrying on of its business of sugar refining may be included in the income from the business, for the purpose of measuring the amount of the tax.

The distinction above indicated is the natural result from the conclusions reached in the *Pollock* case and the *Spreckels* case; the one holding that the income from real estate and invested personal property is not taxable without apportionment, and the other that the income from real estate actually used primarily as incidental to a business which is properly subject to an excise tax, may be included in measuring the amount of the excise tax upon such business.

If we were to assume for a moment, for purposes of argument, that certain acts and things, when done by an individual, do not constitute the "carrying on or doing business," it would seem fairly to follow that if the same acts and things were done by a corporation, they would likewise not constitute the "carrying on or doing business" by the corporation. So, if we assume that an

individual, in investing his money and doing such things as are essential for properly protecting and caring for his investment, is not engaging in business, it would seem to follow that a corporation in doing the same things is not engaging in business, any more than the individual.

If this be conceded, and if the words "carrying on or doing business" in the present Act are to be construed as including such acts of investment, corporations would be taxed directly on their income from real estate and invested personal property. Assuming the present Act to be valid, then, we are brought into direct conflict with the *Pollock* case. The Congress would be able, by a slight change in language from the law of 1894, to enact a general law taxing incomes from invested real estate and personal property. It would be necessary only to describe the tax as laid upon this so-called "business" of investing one's funds, instead of upon the income itself.

If the *Pollock* case is to stand,—and all the debates in the Congress assumed the validity of that decision——the result above pointed out would seem to indicate strongly that Congress could not have intended the phrase "carrying on or doing business" to include such investment.

Let us consider the matter for a moment in another aspect, and perhaps more broadly. The terms "business" and "investment," to the ordinary mind, convey quite opposite and contrary meanings. The one connotes the carrying on of some pursuit,—manufacturing, trading or constructing, primarily utilizing the energies of the individual in the production of wealth; the other conveys the idea of placing one's money,—the product or profits of business,—in some form of property so that it may yield a return *of itself;* the one speaks of *activity,*

the other of *inactivity;* the one is primarily *active,* the other primarily *passive.* It may not be easy to define this difference with accuracy, but one feels that it would not be difficult to place any particular case in the class to which it belongs.

The distinction then is not fanciful but real,—between "business" on the one hand, and "investment" on the other; and the term "business" can no more include "investment" than the term "activity" can include "inactivity."

Moreover, he who is engaged in business, although his object, economically speaking, is to obtain the profits of his labor to himself, is, nevertheless, primarily engaged in serving others.

> "Business may be taken to include all provision for the wants of others, which is made in the expectation of payment direct or indirect from those who are to be benefited. It is thus contrasted with the provision for our own wants, which each of us makes for himself, and with those kindly services which are prompted by family affection and the desire to promote the well-being of others."
>
> Marshall, Principles of Economics, page 348 (London, 1891).

On the facts as they appear from the record, it is submitted that the defendant corporation is not doing business within the meaning of the act, and consequently is not taxable under the act.

II.

The Act is Unconstitutional.

If the defendant corporation is within the intent of the Act, the appellant has standing to contest its constitutionality. It is submitted accordingly that the Act is unconstitutional for the reasons hereinafter set out.

1. The Uncertainty and Ambiguity as to the precise Nature and Incidence of the Tax.

An important light is thrown upon the precise nature of this tax by a consideration of the question *who* is taxed. The Statute seems to be clear upon this question, namely, it is the "corporation, joint stock company, or association," and not the individual who holds the stock therein. Much uncertainty has been created by arguments in favor of the constitutionality of this act to the effect in substance that the tax is laid upon the *privilege of doing business in the corporate form.*

In the case of *Nicol* v. *Ames*, 173 U. S. 509, a stamp tax of one cent per $100 was laid by Congress upon sales of products or merchandise at any exchange or board of trade, the act requiring a memorandum of the sale to be made and delivered by the seller to the buyer with the necessary stamp affixed thereto. A penalty was imposed for violation of the act. The Court upheld the act as an excise tax upon the privilege of the use of the exchange or board of trade and held that the tax might be measured by the value of the property sold, that being a fair measure of the extent to which the privilege was exercised.

The privilege of doing business in the corporate form is not a privilege which is enjoyed by the *corporation* as such; if it were, this tax would be merely a tax on the corporation because it *exists*,—or in other words, a *franchise* or capitation tax; it is primarily not even a privilege which is enjoyed by the *shareholders;* it is a privilege enjoyed by the persons who direct the activities of corporations and actually carry on their business. It enables them to direct such business by means of the use of wealth which is contributed by the shareholders and, as a general rule, the individual returns of the persons directing such activities are received primarily in the form of salaries.

The debates in Congress show that it was the intention of this Act to impose the tax upon accumulated wealth, and that Congress regarded the shareholders of a corporation as investors and not as actors in the doing or carrying on of the business. Senator Root said:—

> "It is not just, and it is universally recognized by the people who have thought carefully and deeply upon this subject that it is unjust, to take a man who is in the enjoyment of a few years of earning capacity—it may be ten or twenty or thirty—when he is turning into money his brains and his nerves and his life; when, if he is wise, if he has a grain of common sense, if he possesses those qualities that we all of us wish to foster and encourage among our people, he will be laying up a portion of that income against the days of his age and his illness and the wants of his family, and impose upon that income, the part that he lives on and the part that he is accumulating as capital. the same imposition that is put upon the income that his neighbor gets from invested securities that last forever. Now, I say the latest and the most considerate treatment of the subject of income tax makes a careful distinction between those two.

> Mr. President, it has so happened that in the development of the business of the United States the natural laws of trade have been making the distinction for us, and they have put the greater part of the accumulated wealth of the country into the hands of corporations, so that when we tax them we are imposing the tax upon the accumulated income and relieving the earnings of the men who are gaining a subsistence for their old age and for their families after them" (Vol. 44, Congressional Record, p. 4068).

The corporation, then, enters the field of business with no especial privilege or advantage to assist it in the struggle of competition against those who are already in the same field of business. The shareholder, as such, on the other hand, is not himself engaged in business. He is the investor who has loaned his wealth to the corporation, to be used by those who direct its activities, and the return upon his stock in the form of dividends is his income from a *personal property investment.*

On the one hand, then, the corporation itself enjoys no special privilege; on the other hand, the shareholder is not engaged in business, but is merely an investor whose income cannot be subjected to a direct tax without apportionment, under the authority of the *Pollock* case. In spite of this, the tax is laid by this Act upon the corporation and its burden is felt by the shareholder in the decrease in dividends.

In view of these facts, it is respectfully submitted—

First. That the tax is laid upon the corporation itself, as such, and not upon the persons who compose it.

Second. That as the tax is laid upon the corporation it cannot be considered as a tax upon the "privilege of doing business in the corporate form." It must be a tax either upon the exercise of its franchise or else upon

the carrying on or doing of its business. It cannot by any specious argument be said to involve the privilege which is enjoyed by those actively interested in the Company.

The Court is faced with these alternatives:—

> (1) If it goes behind the corporation in order to justify the tax as laid upon a privilege enjoyed by persons going to make up the corporation, the tax becomes a tax on the income of personal property invested.
>
> (2) If the Court regards the corporation itself as the unit, there is no special privilege to be taxed and it becomes clear that the tax is laid upon the carrying on or doing business, or upon the exercise of the franchise, and not upon any carefully prepared combination of (1) doing business and (2) privilege of limited liability of shareholders. In such case, the classification in the Act is unreasonable, because corporations only are taxed, all others being exempt.

The debates in Congress show the greatest unwillingness on the part of the sponsors of this Act to disclose the precise thing upon which the excise was laid, and, though firmly pressed for an exact statement, they declined to say more than that the Act intended a tax upon the right or privilege of corporations to transact business and that it might include something more (Vol. 44, Congressional Record, p. 4088, discussion between Senator Brandegee and Senator Root).

The debates show many efforts to have the Act define the precise thing upon which the excise was laid, as, for example, whether upon the corporate franchise or upon the exercise of the corporate franchise, or upon the doing or carrying on of business. These efforts were resisted. The Congress appreciated that the constitutionality of the Act rested not only upon the deter-

mination but also upon the precise definition of the thing upon which the excise was to be placed.

There were two difficulties; *First*, the selection of the privilege upon which the excise was to be laid, and, *second*, the classification of the persons exercising the privilege, if all persons exercising it were not to be taxed.

The difficulty in selecting the corporate franchise or the exercise of the corporate franchise as the special privilege arose from the principle laid down in *California* v. *Central Pacific Railroad Company*.

The special privilege of doing or carrying on business might be made the subject of an excise tax. If the latter were selected as the privilege, the classification which limited the tax only to corporations would be dangerous.

An amalgamation of the two ideas, (1) "of persons organized in corporate form," (2) "carrying on or doing business," was made in the hope that by regarding the individuals as the unit for purposes of classification and the corporation doing or carrying on business as the unit for the purposes of the tax there might be an escape from these difficulties and from the inevitable unconstitutionality of the act which would result if either the shareholders or the corporation were regarded as the unit for both purposes.

In order to sustain the constitutionality of this act, the Court must regard the shareholders (who are not doing business) as the unit for purposes of classification, and the corporation (which among all persons doing business cannot be made a class) as the unit which exercises the privilege subject to the tax.

A complete reading of the debates can only lead to the conclusion that efforts were largely devoted to the selection and maintenance of ambiguous language, in order that in the penumbra of the ambiguity, the presumption of constitutionality in the legislative Act, might prevail.

2. The Tax is in Reality an Income Tax.

The tax is nominally laid upon every corporation, etc., "with respect to the carrying on or doing business by such corporation, etc.," and is stated to be "equivalent to one per cent. upon the entire net income over and above $5,000.00 received by it from all sources during such year exclusive of amounts received by it as dividends upon stock of other corporations, etc., subject to the tax hereby imposed."

Elaborate provisions are contained in the Act relative to the method of determining the amount of receipts and expenditures and of arriving at the net income which is deemed to be taxable.

It is true, on the one hand, that the Court will undoubtedly pay a very high degree of deference to the language whereby Congress has stated this tax to be "a special excise tax .... equivalent to one per centum upon the entire net income etc.," but as was said by Mr. Justice Holmes in *Galveston, Harrisburg, etc., Railway Company* v. *Texas*, 210 U. S. 217, 227:—

> "Neither the state courts nor the legislatures, by giving the tax a particular name or by the use of some form of words, can take away our duty to consider its nature and effect."

In that case a Statute of Texas imposed an annual tax upon railroad corporations, "equal to one per centum of its gross receipts if such line of railroad lies wholly within the state." The lines of the road concerned did lie wholly in the State of Texas, but they connected with other lines, and certain portions of their gross receipts were derived from the carriage of passengers and freight

coming from or destined to points without the State. The Court held that the tax was not a tax on property measured by the amount of the gross income, but was in reality a tax upon the income itself and was, therefore, unconstitutional, and that the act was not helped by the use of the words "equal to."

This looking at the real effect of a tax was emphasized in *Fairbank* v. *United States*, 181 U. S. 283, where it was held that a stamp tax on a foreign bill of lading was in substance and effect on the articles included in the bill of lading and was, therefore, a tax or duty on exports within the prohibition of the Constitution.

And in *Ludwig* v. *Western Union Telegraph Co.*, decided February 21, 1910, this Court declared unconstitutional a statute of Arkansas which required foreign corporations, as a condition of continuing business in that State, to pay a fee based on their total capital stock for filing articles of incorporation in the State. The Court held that this was in substance imposing a burden on interstate commerce, and also taxing property beyond the jurisdiction of the State.

As has been shown heretofore in this brief, the Act nowhere states specifically upon what the tax is levied; the answer to that question is left entirely to inference. In view of this fact it is especially significant to notice that although it is described as a tax "with respect to the carrying on or doing business," it is not measured by the income of the Company from the business alone, but by the income from *all sources*. It is not unnatural to suppose, in the absence of some other convincing feature of the Act, that as the amount of the tax is determined by the net income from all sources, the tax is in reality laid *upon* that net income. It is true that a tax may in fact be laid upon some property or privilege in proportion to the value of some other

property or privilege, without being a tax upon the latter. The theory, however, in any such case must be that the thing which is taken as the standard or measure by which the amount of the tax is determined is a fair standard or measure of the value of the thing upon which the tax is technically laid, and if such standard does not reasonably and fairly measure the value of the thing taxed, that fact is a strong argument that the tax is not in fact laid upon the thing upon which it is said to be laid. The fair question, then, in the present case, is, is the total net income merely a convenient measure of the value of the business done or is it so far unrelated to the business that it is not a fair measure of the value of the business.

It would have been natural, in this case, if the tax were intended in reality as a tax upon the carrying on or doing business, to have made it depend, as to its amount, upon the income derived *from the doing of business* and not upon the income from *all sources*. This was done in the Act which was before the Court in the *Spreckels* case, and the Court in the computation of the income subject to tax in that case, excluded the returns from invested funds not connected with the business.

If a corporation were to carry on its business at an actual loss, yet under this act, if its invested funds in real estate or personal property, having nothing to do with the business conducted, were sufficient to make this total net income over $5,000.00, it would be subject to this tax. The act also provides that as to foreign corporations, the tax shall be based upon the net income "from business transacted and capital invested within the United States, etc."

If the tax were in fact upon the franchise received from the State, it might not be unnatural to gauge the amount of the tax as has been done in this act. If

intended as a special excise tax upon the carrying on or doing business or upon the exercise of the corporate franchise in the carrying on or doing business, it is submitted that in either case it is unnatural to measure the amount of the tax by the income from *all sources* expressly including in the case of foreign corporations income from "capital invested," thereby indicating with clearness the intention to include income from capital invested as to domestic corporations.

The net income from all sources is not a fair standard or measure either of the value of the business carried on or of the value of the exercise of the corporate franchise. The income from real estate and invested personal property is entirely independent of the franchise or its exercise. The fact that the investment is held by a corporation adds nothing to its value, either to the corporation or the shareholders. When, therefore, such income is included in the measure of the amount of the tax, either as a tax upon the business or as a tax upon the corporate privilege in any aspect, there is a clear departure from the natural standard of measuring such value. It is submitted that in view of this apparently deliberate departure from the obvious method of measuring such value, the tax loses its character as "a special excise with respect to the carrying on or doing business, etc.," and becomes in fact and substance a tax upon income, and is unconstitutional under the authority of the *Pollock* case.

3. If not an Income Tax generally, still it is as to the Defendant Company a Direct Tax upon its Income from Real and Personal Estate.

Attention has been called heretofore to the fact that the sole income of the defendant corporation is derived from its real estate and its accumulated profits. It would seem, therefore, that if the care and management of real estate to the extent necessary in the proper oversight of its investments and so far only as is incidental thereto, is to be deemed the carrying on or doing business within this act, it would follow that the defendant corporation is subjected to a tax differing in name only from that which was declared unconstitutional in the *Pollock* case.

Mr. Justice White, in his dissenting opinion in the *Pollock* case, called express attention to the fact that the tax in that case affected income from real estate only in the respect that such rentals were included in the aggregate income from which expenses for insurance, repairs, losses in business, etc., were to be deducted in order to ascertain the taxable net income (pp. 644–645). This fact, *viz.*, that the income from real estate was only one element in the computation, was apparently one of the principal difficulties which caused Mr. Justice White to differ from the opinion of the Court, but notwithstanding the fact that the income from real estate was affected only in this manner, the majority of the Court held the tax unconstitutional. *The fact that it was included in the computation was sufficient.*

In the present case, as regards the defendant corporation, the tax lies directly upon the rentals received from

its real estate and the income from its accumulated profits. The tax on both these elements was held in the *Pollock* case to be a direct tax, and calling it a tax on doing the business of investing money in real and personal estate does not change the substance of the tax. It remains a tax directly upon the income of the defendant from its funds invested in real estate and in personal property, and is as much a direct tax upon such income as if it were laid thereon in name as well as in substance.

4. The Act is Invalid as laying a Burden upon an Instrumentality of the State.

It would appear also that this Act is open to the objection that the tax imposed is a burden upon the instrumentalities of the State within that principle of constitutional law which forbids either the Federal or State government from laying any burden upon the instrumentality of the other.

The defendant corporation, having been organized under a special law, is, in a special and peculiar sense, an instrument of the State in performing the duties which its charter imposed. The performance of such duties is pursuant to a special contract with the State which is not subject to alteration, amendment or abrogation.

If the tax is a tax upon income it is unconstitutional under the principles hereinbefore referred to. If it is regarded as a tax on the franchise granted by the State, or as a tax on the exercise of the franchise, or as a tax on the doing of business, it is submitted that it equally lays a burden upon the instrumentalities of the State.

A review of the authorities, we believe, will show

that any burden placed by either government upon the *exercise or operation* of agencies or instrumentalities employed by the other for the accomplishment of purposes within its exclusive sphere, is as objectionable from this view point as if laid upon the franchise or power of the State itself. The principle of the cases is that neither government is to be hampered in any manner in the conduct of functions which properly belong to it by any action of the other.

In the *Pollock* case, Mr. Justice White, in his dissenting opinion, discussing the case of *Scholey* v. *Rew*, 23 Wallace 331, where a tax was put upon the right to inherit real estate and where the tax was sustained as an indirect tax, said (p. 649):—

> "That decision cannot be explained away by saying that the Court overlooked the fact that Congress had no power to tax the devolution of real estate and treated it as a tax on such devolution."

He regarded it not as a case of tax upon the right to inherit, which he said "Congress had no power to regulate or control," but apparently as a tax on an interest or right in the property itself, and he regarded that case, therefore, as being conclusive to the effect that as that tax was not a direct tax upon the real estate, so the tax in the *Pollock* case should not be considered as a direct tax.

In *Knowlton* v. *Moore*, a further distinction appears to have been taken and the inheritance tax was there sustained as being not a tax upon the power of the State to regulate successions, but as a tax upon a recipient taking property in accordance with those regulations after they have been made. Mr. Justice White delivering the opinion of the Court said (p. 58):—

"The limitation which would exclude from Congress the right to tax inheritances and legacies is made to depend upon the contention that as the power to regulate successions is lodged solely in the several States, therefore Congress is without authority to tax the transmission or receipt of property by death. . . . But the fallacy which underlies the proposition contended for is the assumption that the tax on the transmission or receipt of property occasioned by death is imposed on the exclusive power of the State to regulate the devolution of property upon death. The thing forming the universal subject of taxation upon which inheritance and legacy taxes rest is the transmission or receipt, and not the right existing to regulate."

This case of *Knowlton* v. *Moore* is referred to as sustaining the proposition that although the Federal government cannot tax a franchise or right granted by the State, it can, nevertheless, impose a tax upon the *exercise* of that right by the recipients of the grant.

It is submitted, however, that the necessity for the distinction which is taken in *Knowlton* v. *Moore*, and the real ground for the statement that the power of the State to regulate successions cannot be taxed by the Federal government, is a technical one, namely, that the rights of sovereignty of the State are outside of the power of the Federal government, and that to tax the power of the State to regulate successions, would be inconsistent with the theory of State sovereignty as to matters exclusively within State control.

It is to be noted that, in *Knowlton* v. *Moore*, whether the tax be regarded as assessed upon the *power of the State* to regulate successions or as upon the *right of the recipient* to take, in accordance with the regulations, the functions of the State, so far as they concerned the carrying on of the government and so far as they concerned the

activities of the State in the exercise of its powers for the general welfare of its people or for the carrying on of its legitimate enterprises, were in no way impeded, and that in either aspect of that tax, it imposed no burden upon proper action of the State.

If the present Act lays the tax upon the franchise itself, or in other words upon the power of the State to grant franchises, it falls within the prohibition in *Knowlton* v. *Moore*, against interference with the power of the State. There is, however, in this case, also a *direct burden and impediment* on the governmental activity of the State, and it would seem evident that whatever view be taken of the precise incidence of the tax, this direct burden and impediment still exists.

If we consider for a moment some State function which is recognized as governmental and as being, therefore, beyond the power of the Federal government to tax, such, for example, as the right of the State or any department of the State to borrow money, it must be admitted that it makes no difference so far as impeding the functions of the State is concerned, whether the tax is purported to be laid upon the power of the State to borrow money, or upon the securities which are issued by the State for that purpose, or upon the income received by the holder of those securities. In any of these cases the functions and instrumentalities of the State are clearly beyond the reach of Federal taxation, directly or indirectly. The Federal government can tax neither the power of the State to borrow nor the exercise of that power, nor the receipt by individuals of the price which the State pays for the loan. The tax is a burden upon the proper activities of the State, and is, therefore, unwarranted, whether laid directly or indirectly.

It is submitted that in the present case there can be no distinction whether the tax is regarded as laid upon

the corporate franchise granted by the State or upon the exercise of that franchise or upon the doing of business (which is exercising the franchise). In any of these aspects the tax is a burden upon the franchise, and upon the ability of the State to act by such means.

The question remaining, therefore, is whether such franchise, or the specific activity if undertaken by the State itself, or the end which the State may have in view in the granting of such franchise, can properly be subjected to the Federal tax. If the particular object of the State in granting any particular franchise or the particular enterprise which is being fostered by the State in this manner is of that class of State activity which is free from Federal control, the tax cannot be laid.

In the case of *California* v. *Central Pacific Railroad Company*, 127 U. S. 1, the defendant was a California corporation which received certain valuable franchises from Congress in connection with the undertaking which was entered into by the United States relative to the construction of a through line of railroad from the Missouri River to the Pacific Ocean. It had become to all intents and purposes a Federal corporation. The State of California undertook to levy a tax upon all the property and franchises of the Company. The Court said (per Bradley, J., pp. 40–41):—

> "Assuming then, that the Central Pacific Railroad Company has received the important franchises referred to by grant of the United States, the question arises whether they are legitimate subjects of taxation by the State. They were granted to the company for national purposes and to subserve national ends. It seems very clear that the State of California can neither take them away, nor destroy nor abridge them, nor cripple them by onerous burdens. Can it tax them? It may undoubtedly

tax outside visible property of the company, situated within the State. That is a different thing. But may it tax franchises which are the grant of the United States? In our judgment, it cannot. . . . A franchise is a right, privilege or power of public concern, which ought not to be exercised by private individuals at their mere will and pleasure, but should be reserved for public control and administration, either by the government directly, or by public agents, acting under such conditions and regulations as the government may impose in the public interest, and for the public security. Such rights and powers must exist under every form of society. They are always educed by the laws and customs of the community. Under our system, their existence and disposal are under the control of the legislative department of the government, and they cannot be assumed or exercised without legislative authority. No private person can establish a public highway, or a public ferry, or railroad, or charge tolls for the use of the same, without authority from the legislature, direct or derived. These are franchises. No private person can take another's property, even for a public use, without such authority; which is the same as to say, that the right of eminent domain can only be exercised by virtue of a legislative grant. This is a franchise. No persons can make themselves a body corporate and politic without legislative authority. Corporate capacity is a franchise. The list might be continued indefinitely.

In view of this description of the nature of a franchise, how can it be possible that a franchise granted by Congress can be subject to taxation by a State without the consent of Congress? Taxation is a burden, and may be laid so heavily as to destroy the thing taxed, or render it valueless. As Chief Justice Marshall said in *McCulloch* v. *Maryland*, 'the power to tax involves the power to destroy.' Recollecting the fundamental principle that the Constitution, laws and treaties of the United States are the supreme law of the land, it seems to us al-

most absurd to contend that a power given to a person or corporation by the United States may be subjected to taxation by a State. The power conferred emanates from, and is a portion of, the power of the government that confers it. To tax it, is not only derogatory to the dignity, but subversive of the powers of the government, and repugnant to its paramount sovereignty. It is unnecessary to cite cases on this subject. The principles laid down by this court in *McCulloch* v. *Maryland*, 4 Wheat. 316; *Osborn* v. *The Bank of the United States*, 9 Wheat. 738; and *Brown* v. *Maryland*, 12 Wheat. 419; and in numerous cases since which have followed in their lead, abundantly sustain the views we have expressed. It may be added that these views are not in conflict with the decisions of this court in *Thomson* v. *Pacific Railroad*, 9 Wall. 579, and *Railroad Company* v. *Peniston*, 18 Wall. 5. As explained in the opinion of the court in the latter case, the tax there was upon the property of the company and not upon its franchises or operations. 18 Wall. 35, 37."

In *Railroad Company* v. *Peniston*, 18 Wallace, 5, it was held that a state could impose a tax upon the real and personal property, as distinguished from the franchise, of the Union Pacific Railroad Company, a Federal corporation.

The Court said, speaking by Mr. Justice Strong (p. 36):

"It is therefore manifest that exemption of Federal agencies from State taxation is dependent, not upon the nature of the agents, or upon the mode of their constitution, or upon the fact that they are agents, but upon the effect of the tax; that is, upon the question whether the tax does in truth deprive them of power to serve the government as they were intended to serve it, or does hinder the efficient exercise of their power. A tax upon their property has no such necessary effect. It leaves

> them free to discharge the duties they have undertaken to perform. A tax upon their operations is a direct obstruction to the exercise of Federal powers. "

It would appear, then, that the granting of a franchise is an attribute of sovereignty, and that a state may not in any manner obstruct the operation of any franchise granted by the Federal government.

The rule is reciprocal. The states, also, within their reserved powers are no less sovereign than is the Federal government within its granted powers and the same reasons would seem to apply for denying to the Federal government the right to obstruct or impair the operation of franchises granted by the state as apply for denying the right of the state to obstruct or hinder franchises granted by the Federal government. The rule in each case rests upon the principle of *the absolute and independent sovereignties of the Federal and State governments within their respective spheres of action.*

In *Collector* v. *Day*, 11 Wallace, 113, the decision went only to the point that it was not competent for Congress to impose a tax upon the salary of a judicial officer of the State. After discussing the cases of *McCulloch* v. *Maryland*, 4 Wheat. 316, and *Weston* v. *Charleston*, 2 Peters, 449, the Court referred to the case of *Dobbins* v. *Commissioners of Erie*, 16 Peters, 435, which determined that the states were prohibited from taxing the salary or emoluments of an officer of the Federal Government, and said (p. 124):

> "We shall now proceed to show that, upon the same construction of that instrument and *for like reasons*, that government is prohibited from taxing the salary of the judicial officer of a State." (Italics ours.)

and further (pages 124, 127):

> "The general government, and the States, although both exist within the same territorial limits, are separate and distinct sovereignties, acting separately and independently of each other, within their respective spheres. The former in its appropriate sphere is supreme; but the States within the limits of their powers not granted, or in the language of the tenth amendment, 'reserved,' are as independent of the general government as that government within its sphere is independent of the States. . . . And if the means and instrumentalities employed by that government to carry into operation the powers granted to it are, necessarily, and, for the sake of self-preservation, exempt from taxation by the States, why are not those of the States depending upon their reserved powers, for like reasons, equally exempt from Federal taxation? Their unimpaired existence in the one case is as essential as in the other."

In *Fifield* v. *Close*, 15 Mich. 505, holding that so much of the Federal Internal Revenue law as required process in state Courts to be stamped as a condition of the validity of legal proceedings, was unconstitutional, the Court bases its reasoning squarely upon the principle of the absolute sovereignty of the State within its proper sphere. The following language is especially significant (p. 508):—

> "The same supreme power which established the departments of the general government, determined that the local governments should also exist for their own purposes, and made it impossible to protect the people in their common interests without them. Each of these several agencies is confined to its own sphere, and all are strictly subordinate to the constitution which limits them, and independent of other agencies, except as thereby made

> dependent. There is nothing in the constitution which can be made to admit of any interference by Congress with the secure existence of any state authority within its lawful bounds. And any such interference by the indirect means of taxation, is quite as much beyond the power of the national legislature as if the interference were direct and extreme."

See also:

> *Smith* v. *Short*, 40 Ala. 385;
> *Warren* v. *Paul*, 22 Ind. 276;
> *Jones* v. *Estate of Keep*, 19 Wis. 369;
> *Union Bank* v. *Hill*, 3 Cald. (Tenn.) 325;
> *Moore* v. *Quirk*, 105 Mass. 49.

In *United States* v. *Owens*, 100 Fed. 70, it was held that the bond required by the statute of Missouri to be given by a saloon keeper as one of the conditions of his receiving a license from the State was not subject to taxation by the Federal government.

The Court, after referring to such cases as *Collector* v. *Day*, and *McCulloch* v. *Maryland*, said:

> "These cases, and many others to which reference might be made, establish the principle that the great law of self-preservation, the inherent attribute of sovereignty exempts any and all means or instrumentalities of State governments from Federal taxation in the same way and manner as it exempts any and all means or instrumentalities of the Federal government from State taxation."

The Act of Congress now under discussion makes no exception of corporations which may be organized or whose franchises may be granted by the State for the accomplishment either of those functions which are

strictly necessary to the maintenance and support of the government itself or of those functions which are properly called governmental but which have to do with the development of the resources of the State, the fostering of its internal commerce or the advancement of its industries.

It is true that the Act applies only to corporations "organized for profit." This would exclude, of course, municipal corporations, and it will be argued doubtless that no corporation organized for profit can come within the category of those instrumentalities with which th Federal government is forbidden to interfere.

It is submitted, however, that there is a class of corporations which are organized for profit and which are engaged in business, but which ought at the same time to be regarded as exempt from Federal taxation because they are instrumentalities of the State, which are enfranchised by the State in the exercise of its exclusive governmental powers and with which the Federal government has no right to interfere. We refer especially to public service companies engaged, for instance, in public lighting business or in commerce which is exclusively carried on within the State. Such, for example, are interurban railways which do not form a link in an interstate line. Such public service enterprise inside State lines is as much in the exclusive power of the State as is interstate commerce in the exclusive power of the Federal government. Many of such corporations are endowed with the essentially sovereign power of *eminent domain*. Surely matters of such public import as to be aided by this power are of sufficient moment to the State so that the State should be unhampered in its conduct of them. Such activities by the State cannot properly be called less than "governmental"; and are in many cases of almost immeasurable impor-

tance to the State; and an impediment in their way may be of vastly more importance than a tax upon municipal bonds.

It was held in *California* v. *Central Pacific Railroad Company,* above cited, that a State could not tax a franchise held by a federal corporation which related to interstate commerce and which was granted by Congress as an aid to the development of that commerce. It was held also in *Galveston, Harrisburg, etc., Railway Company* v. *Texas,* 210 U. S. 217, that a tax equal to one per cent. of the gross receipts could not be levied by a State upon a railway situated entirely within the State, because such receipts were made up in part of the income from carriage of through freight and passengers to and from points without the State over connecting lines, this being a restraint upon interstate commerce.

There are many cases, which it is unnecessary to cite here, holding that even an indirect burden on interstate commerce may not be imposed by State laws.

It is submitted particularly upon the authority of the case of *California* v. *Central Pacific Railroad,* that such *intrastate* corporations are without the control of the Federal government in the same manner and to the same extent and for the same identical reasons that *interstate* corporations are without the control of the States. In view of the Galveston case above cited, it would seem clear that it would have made no difference in the California case if the tax had been laid upon the income of the interstate Company instead of directly and in terms upon the franchise. Compare *Philadelphia etc., S.S. Co.* v. *Pennsylvania,* 122 U.S. 326.

It will be contended that this doctrine is overruled or modified by the case of *South Carolina* v. *United States,* 199 U.S. 437, where it was held that the Federal excise tax levied upon dealers in intoxicating liquors should be

applied to the persons authorized by the State of South Carolina, under its dispensary laws, to carry on the sale of liquor within that State. The decision of the majority of the Court upholding the law so applied as being constitutional, appears to rest upon two grounds: *first*, that as the tax was properly levied upon the doing of the business, it made no difference that in this case it was conducted by the State, and that if it were conceded that the State might undertake such private business and be exempt from the tax, the entire internal revenue of the Federal government might by that method be taken away if the State should see fit to engage in those kinds of private business upon which internal revenue taxes were laid; *second*, that the prohibition of Federal interference includes only governmental functions of the State as distinguished from business which is of a private nature, and that if the State engages in the latter, such business is not thereby withdrawn from the taxing power of the Federal government.

The distinction to which we respectfully ask the attention of the Court with respect to this case is that the business in which the State of South Carolina was engaged was a business of a strictly private nature. It was a business, to be sure, which, under the police power, the States have a right to control or even to prohibit, yet it was, nevertheless, a private business which individuals might carry on but which did not conduce in any way to the development of the resources of the State or of its internal commerce or industry. It was not a thing which required as a condition of its prosecution the affirmative sanction and assistance of the State.

It is submitted that the above decision would not have been reached if the industry in question had been one of a public nature having to do with the proper functions of the State in developing its resources and serving its

people, such as the public service companies referred to. Such activities as these, it is submitted with confidence, are activities with the development of which the State is charged. They are matters which rest in the power of the State exclusively, and are of such public nature that Congress has no right nor power to destroy them nor to burden the State in any efforts which it may make for their advancement.

5. If the Tax is upon the Franchise or the Exercise of the Franchise, it is a Direct Tax.

It has been argued that whether the tax is laid in fact upon the corporate franchise or upon the exercise of the franchise or upon doing business, it is invalid as imposing a burden on the instrumentalities of the State. If it be regarded as laid upon either the franchise or the exercise of the franchise we submit that it then has a strong resemblance to a capitation tax and is a direct tax upon the corporation. The corporate franchise is the corporate existence, and the exercise of the franchise is the performance of its natural functions by the body corporate. A tax upon either is direct in the sense that it cannot be shifted by the corporation so that the burden will fall on some one else,—or in other words, it is direct in the economic sense.

It cannot be said, arbitrarily, that with the case of *Hylton* v. *U. S.* and the *Pollock* case, it has been forever settled that no tax can ever be direct in the constitutional sense except the capitation tax, the tax on land, and the tax on the income from land and from invested personalty. This tax, in the present view, is *ejusdem generis* with the capitation tax or with a tax on an individual

entering a business career, imposed because he is a college graduate or because he is redheaded.

6. The Act is Invalid, because of Lack of Equality.

If it should be held that the tax in question is not a direct tax, there remains the objection of the lack of equality.

Whether or not the case of *Knowlton* v. *Moore* is conclusive to the effect that the requirement of uniformity in taxation means only geographical uniformity or whether uniformity contains more than this, such, for example, as that an excise tax on a particular business must be imposed equally upon all who carry on that business, is not believed to be material for two reasons:

(1) The power of taxation, although a necessary power of Government, is not a power to be exercised arbitrarily or unreasonably. It is a power which inherently demands to be exercised on the principles of reasonable equality. This idea of reasonable equality must exist independent of any uniformity provisions. It was assumed by counsel on both sides in the *Pollock* case to be a necessary condition in the grant of the taxing power to Congress. This equality requirement would doubtless permit classification in taxation just as classification is permitted in the exercise of the police power of the States, but such classification in the exercise of the Federal power of taxation, just as in the exercise of the State power of police, should bear reasonable relation to the object to be taxed.

(2) The Fifth Amendment to the Federal Constitution prohibits Congress from depriving any person of

life, liberty or property without due process of law, and from taking private property for public use without just compensation.

The Fourteenth Amendment limiting the powers of the States contains additional language forbidding the denial of the equal protection of the laws. This Fourteenth Amendment, although permitting classification, has been held in numerous cases to require not only in police regulations but also in the tax laws that any classification adopted must be reasonable with respect to the object of the law.

In case of police regulations it is not clear that an unequal application of such a law conflicts with anything in the Fourteenth Amendment, except the equal protection clause.

When we come, however, to taxation laws in which the State takes from the individual who is taxed a certain proportion of his money or property it would seem that, if different persons were burdened unequally, in the absence of some reasonable basis for classification, their rights under the due process clause would also have been impaired, or, in other words, if a certain kind of property is taxed in the hands of one person at one rate and in the hands of another person at a higher rate the latter would have been deprived of property without due process of law and, at least to the extent of the inequality, his property would have been taken for public use without just compensation.

The present act would appear to violate these principles of equality in the following particulars:—

(a) *It Imposes a Tax upon a Business only when done by a Corporation.*

The application of this principle of equality to the case of an excise tax upon the carrying on of any particular business would require that the *same rate of tax* be laid upon the *same business* everywhere throughout the United States. If one rate of tax were imposed in one part of the country and another rate elsewhere, or if one rate were imposed upon the carrying on of a certain business by any particular class of persons, and another rate upon the same business by other classes of persons, the requirement of equality would be clearly violated; so that, for instance, if corporations only were subjected to a tax with respect to the carrying on of the business of sugar refining, while individuals carrying on the same business were exempt, this fundamental principal of equality would require that such tax be declared unconstitutional and void.

Coming, then, to a consideration of the present Act, it is clearly apparent that by whatever name this tax be called, and whatever definition be adopted as to the exact thing upon which this tax technically falls, it involves the evil and injustice of the case just supposed, but many times magnified. Under this act, not only is every corporation carrying on the business of *sugar refining* in the United States subjected to this tax,—all individuals and co-partnerships being free to carry on the same business without tax,—but *the evil is extended to all kinds of business in which corporate enterprise has embarked.* A corporation carrying on any manufacturing business or any financial or commercial business, no matter how small may be the interests involved, is obliged to compete with individuals or others

who may be engaged in the same kind of business, and is at a great disadvantage by reason of the burden so cast upon it.

A striking illustration is found in the case of the defendant Company, It has been shown above that the defendant Company is engaged solely in investing its funds in real estate, managing and caring for the property owned by it and receiving the rentals and income therefrom, and that *it does nothing else*. It also appears from the record (pp. 4, 5), that real estate in the City of Boston is largely held, managed and conducted by so-called real estate trusts, having no franchise from the State, and consisting merely of trusts in which the beneficial interests of the *cestuis que trustent* are represented by certificates. The defendant is thereby brought into direct competition with these real estate trusts, and if the tax be held to apply to the defendant, it is placed at a very great disadvantage thereby.

It is not difficult to multiply instances of this sort in every kind of business or pursuit. In every city and in many of the towns will be found, on the one hand, individuals or co-partnerships, and, on the other hand, small corporations, which have been organized to take advantage of the laws which the States have properly made for the encouragement of industry and commerce, and these are in competition with the others in doing the same kind of business. It is not difficult to foresee the probable effect upon corporate enterprise, particularly in the less thickly settled parts, and so far as the smaller corporations are concerned we may expect that the result will be to discourage those forms of enterprises and developments which the State, by the adoption of corporation laws which it deemed wise, has seen fit to encourage.

It is only necessary to add that no sufficient reason

is apparent for laying the burden of this tax upon corporations, joint stock companies and associations having a capital stock divided into shares, and exempting all others.

(b) *The Exemption of Agricultural and Horticultural Organizations.*

The act exempts agricultural and horticultural organizations. Upon the question of reasonable classification, we may fairly take decided cases bearing upon similar classification in the exercise of the police power of the States.

In *Connolly* v. *Union Sewer Pipe Company*, 184 U. S. 540, the anti-trust statute of Illinois was declared unconstitutional on the ground that in exempting from its operation the producers of agricultural products or live stock, it transgressed the requirement of equality.

No reason is apparent, having relation to the difference between the objects of these two acts, which would make the exclusion of agricultural organizations in the one case a reasonable exclusion, and in the other, an unreasonable one. The Illinois statute in the *Connolly* case was distinctly an anti-trust measure. There is a widespread and prevailing opinion based upon the admissions of those who stood sponsors for this act that one of the objects of the present act is not dissimilar, namely,—Federal control of State corporations.

(c) *The Exemption of Domestic Building and Loan Associations.*

Upon the inequality and lack of reasonable basis in the exemption of these associations, we can do no better than to refer to the language of Mr. Justice Field in his

concurring opinion in the *Pollock* case [157 U. S. at page 598].

The immense amount of property owned by these associations emphasizes the injustice of exempting them from the tax which others engaged "under different names in similar business" are obliged to pay.

7. The Act is Unconstitutional because the Returns are made Public Records.

The clause in the constitution whereby the taxing power is granted to Congress is as follows:—

(Article 1, Section 8, Clause 1) "The Congress shall have power,—

To lay and collect taxes, duties, imposts, and excises to pay the debts and provide for the common defence and general welfare of the United States; but all duties, imposts, and excises shall be uniform throughout the United States."

That portion of the act which provides that the returns made under it "shall constitute public records and be open to inspection as such," would seem to be unnecessary and uncalled for so far as concerns any purpose of raising money or enforcing the making of correct returns or the collection of the tax, and falls outside of the taxing power of Congress.

In *McCray* v. *United States*, 195 U. S. 27, 64, the Court said:—

> "If a case was presented where the abuse of the taxing power was so extreme as to be beyond the principles which we have previously stated, and where it was plain to the judicial mind that the power had been called into play not for revenue

but solely for the purpose of destroying rights which could not be rightfully destroyed consistently with the principles of freedom and justice upon which the Constitution rests, that it would be the duty of the courts to say that such an arbitrary act was not merely an abuse of a delegated power, but was the exercise of an authority not conferred."

It is submitted that the Court cannot say that Congress would have enacted the tax provisions independently of the publicity provisions. and consequently that as the provision making the returns public records is unconstitutional in its character, the whole of Section 38 should be declared unconstitutional.

III.

THE JUDGMENT OF THE CIRCUIT COURT OF THE UNITED STATES FOR THE DISTRICT OF MASSACHUSETTS SHOULD BE REVERSED.

Respectfully submitted,

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